



Warren Buffett: Don't Trust Air Canada (TSX:AC) Stock

Description

Air Canada ([TSX:AC](#)) stock rose nearly 50% in a matter of weeks. Multiple promising vaccines could be on the way in 2021, meaning there's light at the end of the tunnel for the COVID-19 pandemic.

For airlines, the upside is clear. Passenger traffic plummeted this year, as the world shut down. Travel is still depressed, with many would-be flyers staying home or choosing alternative forms of transportation.

If the world gets vaccinated in 2021, airline traffic could rebound heavily. Many argue that there's pent-up travel demand, and when customers feel safe, they'll swamp airports like never before.

Still more than 50% below its all-time high, Air Canada is looking like a high-upside bet. There's only one problem: Warren Buffett says otherwise.

This story is messy

Betting on airlines right now is more [complicated](#) than what happens to passenger traffic. Demand could surge in 2021, doubling or even tripling in size, and these stocks could *still* be in trouble.

Warren Buffett [explained](#) the situation nicely more than a decade ago when he said airline investors have historically been "attracted by growth when they should have been repelled by it."

There's a lot to unpack there. Let's use Air Canada as an example.

Last decade, the company's sales skyrocketed higher. There's only one possible explanation for this: the company flew significantly more passengers. And because planes have a strict maximum occupancy, that means Air Canada purchased more planes.

Herein lies the problem. To expand, airlines need to buy more planes. That's expensive, but it's also risky. If demand dips for a year, or even a few months, airlines are still stuck with those planes. That means there are just as many planes chasing much fewer passengers.

The situation is similar today, except on steroids. Air Canada still has just as many planes as it did in 2019, but passenger traffic is down 90%. That's a recipe for disaster.

Should you bet on Air Canada stock?

Here's the key: airlines need to run close to full capacity to generate profits. Warren Buffett saw that early. He understood that airline supply isn't very flexible, even though demand could change on a dime.

Growth, Buffett argued, looked good to the average investor, but industry-wide risk was rising at the same time. More and more supply was being added to the market to fuel this growth. When demand inevitably dipped due to economic uncertainty, an act of terrorism, or a global pandemic, carriers like Air Canada would feel a ton of pain.

There's a reason why Buffett now owns zero airline stocks. Industry CEOs think it'll take a few years for demand to reach 2019 levels, even with a vaccine in 2021. That means there will be way too many planes versus passengers. This was the case in the 1980s and 1990s, when airline stocks produced very little gains.

Air Canada shares could be a good buy at some point, but the road ahead is still long and full of unforeseen challenges. There's light at the end of the tunnel for the pandemic, but not for airlines.

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